



CALIFORNIA INDUSTRIAL DEVELOPMENT FINANCING
ADVISORY COMMISSION

STRONGER STATURE, GREENER PROJECTS,
GREATER PUBLIC BENEFIT

A Strategic Plan

June 2008

PLAN OVERVIEW

This strategic plan provides a blueprint to reinvigorate CIDFAC, establish it as a leader of economic development in California, and make it an engine that helps power California's fast-growing green economy.

Major Elements

- Empower CIDFAC by expanding its limited authority to issue industrial development bonds (IDBs).
- Bolster CIDFAC's stature and leadership role in statewide economic development – aggressive marketing, broad-based outreach, and partnerships with California Debt and Investment Advisory Commission, government agencies, nonprofits and others.
- Strengthen the quality of projects, and the public benefits provided by projects, by reforming the system used to grade projects.
- Green CIDFAC projects by injecting into the grading system a greater emphasis on environmental benefits.
- Position CIDFAC as a driver of California's green economy – use marketing, outreach and staff expertise to proactively seek out green and clean tech manufacturers and finance their development.
- Help solidify California's place at the forefront of high tech, biotech and other knowledge-based sectors by working to expand federal law so such companies can receive IDB financing.

BACKGROUND

CIDFAC: Lost Relevance?

The California Industrial Development Financing Act (Government Code section 91500 et seq.) was enacted in 1980. In passing the statute, the Legislature found that tax-exempt bond financing would “benefit economically distressed communities with concentrated unemployment ... (and) which are making diligent efforts to maintain and provide services to existing companies and to prevent the loss of existing jobs.”

The Legislature further found the financing method would help create jobs for persons living in economically distressed areas. The tax-exempt bond financing, the Act specified, was needed to help manufacturers buy, build or refurbish their facilities and, as a result, increase jobs. The Act established CIDFAC as the designated statewide entity to help achieve the Legislature’s objectives.

Under its current statutory authority, however, CIDFAC simply acts as an “approval agency” for the issuance of IDBs by local agencies to California manufacturers. In this role, CIDFAC’s two main responsibilities are to ensure that: (1) projects which receive IDB financing provide certain public benefits which outweigh any public detriment; and (2) IDBs are adequately secured, they will be repaid, and investors who buy the bonds will not be defrauded.

Some in the economic development community believe this role is too limited. They say CIDFAC has lost relevance over time or, worse, become virtually obsolete. This plan seeks to help CIDFAC attain the stature it warrants under the Act. More specifically, the plan proposes ~~immediate and~~ near-term and longer-term improvements to CIDFAC’s existing program:

- Amend CIDFAC’s statutory authority to significantly expand CIDFAC’s ability to issue IDBs. Participants in California’s IDB market indicate this probably is the most important step toward bolstering CIDFAC’s relevance. Such legislation also would change CIDFAC’s name to the California Economic Development Finance Authority (CEDFA).
- The new issuance program would focus on financing projects that: provide workers good-paying jobs and health care benefits; produce environmentally friendly or “green” products; or use environmentally sensitive, or “green” commodities or processes, in their production facilities.
- Use rule changes, and aggressive marketing and outreach, to establish CIDFAC as a driver of California’s green economy. Partnerships with relevant governmental agencies, local economic development officials, nonprofit groups and others also would play a key role in this effort.

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- Use robust marketing, as well as changes in rules and procedures, to make CIDFAC more user-friendly and important to issuers and manufacturers, and to help CIDFAC perform its duty under the Act to ensure projects provide public benefits.

~~In addition to immediate and near-term actions, the plan discusses longer-term initiatives that would broaden CIDFAC's role in economic development to encompass infrastructure development.~~

Why CIDFAC Matters to California's Economy

California's manufacturing sector contributes to the state's economic prosperity by creating high-wage jobs, and by developing and commercializing products and processes that meet demand in national and world markets. CIDFAC serves these manufacturers.

The Milken Institute, in a 2002 report, found that manufacturing's importance to California's economy often gets overlooked relative to the more high-profile knowledge-based sector, including high tech. The report reads, in part:

“[I]t is erroneous to view manufacturing as obsolete. It too is an important driver for growth in our diverse economy ... The driving forces of California's economy are industries that produce goods and services for sale outside the state. Manufacturing is California's most export-intensive activity. The income and employment that manufacturing generates circulates, multiplies and ripples throughout California's regions ...”¹

A 2005 report by the Bay Area Economic Forum stressed California cannot afford to overlook the contributions of its manufacturing sector. The report reads, in part:

“...California leads the nation in manufacturing jobs, and its base ranges from metal to beverage production to high tech ... [H]igh tech goods – computers and electronics, semiconductors, medical devices and communications gear – account for a large portion of manufacturing employment (22%) ... [A] full third of jobs (33%) are in so-called ‘heavy manufacturing’ – automobiles, fabricated and primary metals, and aerospace and defense equipment. Consumer perishable goods – food, apparel, and beverage and tobacco – make up another 18% of jobs ... In 2003, manufacturers supported 1.5 million jobs, nearly 10% of state employment. Those figures translate into nearly \$150 billion of

¹ DeVol, Ross C., Armen Bedroussian, Rob Koepp, and Perry Wong. Manufacturing Matters: California's Performance and Prospects. Milken Institute. August 2002. (The report uses the electronics manufacturing sector as an example of how the employment multiplier works. The electronics manufacturing industry has a multiplier of 3.3, meaning that for each job created in electronics, another 2.3 jobs are created in other sectors.)

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value added ... Based on a direct multiplier effect of 3.0 ... manufacturing supports as many as 4.5 million jobs in California – 30% of its total.”²

However, according to the report, California manufacturers face “... extreme cost-related pressures, with high wage and benefits rates, as well as high input costs such as electricity. They must also deal with regulatory challenges that are greater than in other states and are absent from many developing, low-cost countries...”³

The report argues that these cost and regulatory pressures may drive the state’s manufacturers to other states or countries and that, “[w]hile not all jobs are at risk of moving (some, in food processing or defense, for example, are either linked to specific geography or can’t move offshore), approximately 1 million California jobs are ‘up for grabs’.”⁴

The report suggests state government has a role in addressing these pressures and in ensuring that California retains these firms and the jobs they create. In terms of CIDFAC’s mission, that’s right in its wheelhouse.

Going Green

It will take a team effort for California to successfully implement its groundbreaking climate change strategies and address other environmental concerns. Manufacturers will have to make a crucial contribution to that effort, and CIDFAC can help them.

By changing its system for evaluating and approving projects, CIDFAC can encourage use of environmentally sensitive chemicals and other industrial commodities, deployment of environmentally sound production processes and construction of “green” industrial facilities.

Businesses and other market players increasingly consider environmental sustainability a financial imperative. A 2007 advisory published by Deloitte Development LLC titled, “Creating the ‘Wholly Sustainable Enterprise’,” addresses the economic forces driving companies to “go green” and produce “green” products. The advisory reads, in part:

“Sustainability is rapidly emerging as a critical element of business strategy, driven by a convergence of factors – increasing regulation, changing customer expectations, competitor and technology advances, value chain partner requirements, brand equity protection, and global risk management...Companies must undertake sustainability-driven transformation efforts in order to improve financial, environmental and social performance. Sustainability, approached the right way, can be a significant driver of

² One Million Jobs at Risk: The Future of Manufacturing in California. Bay Area Economic Forum. March 2005.

³ Ibid.

⁴ Ibid.

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enterprise value and must generate economic value in order to evolve from an environmental specialty to a mainstream growth engine ...”⁵

Further, a 2007 *Industry Week* article titled, “Green Manufacturing: An Inconvenient Reality,” reads:

“... [T]he noose around manufacturers’ necks to produce environmentally friendly products gets tighter and tighter. Need evidence? Consider this: In 2004 the business sector shouldered 65% of environmental regulatory costs, with manufacturers paying an average of \$4,850 per employee, according to a 2005 U.S. Small Business Administration report ... One way manufacturers can soften the regulatory blow, say industry experts, is by being more proactive in developing products with minimal environmental impact ... Part of this beat-them-to-the-punch approach includes embracing green technology as a marketing advantage.”⁶

In addition to nurturing more sustainable manufacturing, CIDFAC can help the state’s green economy flourish by financing businesses which manufacture renewable energy products, energy efficiency products and other green tech products. CIDFAC can achieve this critical objective by favoring such enterprises in its project evaluation system and through targeted marketing activities.

California’s green economy is on the verge of a boom period that some say will produce the next big wave of job creation, economic growth and prosperity. According to Next 10⁷, California has seen a 40-fold increase in venture capital (VC) investment in green energy enterprises since 1996, when just \$20 million was available. VC investment in clean tech in California exceeded \$1 billion in 2006. That same year, Californians held

⁵ Creating the “Wholly Sustainable Enterprise”: Driving Shareholder Value Through Enterprise Sustainability. Deloitte Development LLC. 2007.

⁶ Katz, Jonathan. “Green Manufacturing: An Inconvenient Reality,” *Industry Week*, May 1, 2007. (In January, *Industry Week* reported that speakers for an April 2008 Sustainable Manufacturing Summit in Chicago include “sustainability experts” from such large corporations as GE, Dell, HP, Phillips, Honeywell, Subaru, Johnson Controls, Kimberly-Clark, Cadbury Schweppes, Sharp, Caterpillar, Frito Lay, GM, General Mills, and Duke Energy. The article states that, “[w]ith sessions focusing on climate-friendly product development, operational response, sustainable supply chains, and waste management, the Sustainable Manufacturing Summit covers carbon reduction at every stage of the manufacturing process.” This shows that “green manufacturing” as an economic objective is accepted by the mainstream manufacturing sector.)

⁷ On its website, Next 10 describes itself as follows: “Next 10 is an independent, nonpartisan organization that educates, engages and empowers Californians to improve the state’s future...Next 10 is focused on innovation and the intersection between the economy, the environment, and quality of life issues for all Californians. We create tools and provide information that fosters a deeper understanding of the critical issues affecting all Californians. Through education and civic engagement, we hope Californians will become empowered to affect change. We call ourselves Next 10 because we are not here for the quick fix. Our sights are set on joining with others to improve the state over the next ten years, and the ten years after that. The decisions we make together will affect California’s economy, environment and quality of life for years to come. Together, we can create the brighter future we all want for ourselves and our children.”

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almost 45 percent of the nation's patents in solar energy technology and roughly 37 percent of the wind energy patents. For small green entrepreneurs, the tax-exempt financing provided by CIDFAC can serve as an important supplement to venture capital.

The key word in the plan to green CIDFAC is “help.” Implementation of this plan will *help* CIDFAC contribute substantially to the “greening” of California's economy by *helping* CIDFAC *help* the state's manufacturers *help* California achieve its environmental aspirations.

The Knowledge-Based Sector: Untying CIDFAC's Hands

Our state stands at the forefront of the knowledge-based economy. Our leadership in creating jobs and economic growth in the biotech and high-tech fields is well-known. For example, California leads the country in the number of biotech firms. In 2005, according to Ernst & Young's 2007 report, “Beyond Borders: The Global Perspective,” California was home to 375 of the nation's 1,415 biotech companies and 53,000 of the nation's 250,000 biotech workers.

But California also is positioning itself to be at the hub of activity in the lesser-known nanotech and geospatial tech sectors.

Under the President's High Growth Job Training Initiative, the National Nanotechnology Initiative recently received a \$1.5 million grant to fund a California Nanotechnology Workforce Training Program under the auspices of the California Institute of Nanotechnology. In California, occupations identified as “geospatial technology-related” are expected to add roughly 100,000 new jobs across all industries by 2014.

Many of these firms are small businesses, which are the drivers of California's economy and the target recipients of IDB financing. About two-thirds of biotech firms employ 135 workers or fewer. And 80 percent of IT workers are employed by small companies. Providing tax-exempt bond financing for these firms will allow them to grow in California, create high-paying jobs, keep the state on the cutting edge of the new economy, and sharpen our state's competitive edge.

Unfortunately, under current federal tax law governing IDBs, knowledge-based firms do not qualify to receive financing. Recognizing the importance of this sector to California's economic future, this plan seeks to remove the federal restriction so these businesses can access low-cost financing and thrive in our state.

THE PLAN

Near-Term Program Actions

Staff proposes the following immediate actions be taken to improve CIDFAC's existing program and establish a broader, more intensive marketing effort for the state's IDB program:

- ***Similar to the allocation process for CIDFAC's Small Business Program (SBP), the California Debt Limit Allocation Committee (CDLAC) may delegate all of the IDB pool allocation to CIDFAC for award to individual projects.*** With such delegation, CIDFAC will approve both the issuance of IDBs by local issuers and the allocation of IDBs to local issuers and the California Infrastructure and Economic Development Bank (I-Bank). This "one-stop shop" process will benefit the IDB community. It will allow the award of allocation on a monthly basis throughout the year and eliminate what is perceived by the community as an unnecessary duplication of effort by CIDFAC and CDLAC.

Status: In place for 2008.

- CIDFAC staff recently has engaged in periodic conversations with IDB issuers about certain practices in the bond issuance process that CIDFAC finds objectionable, and about certain provisions in the bond documents CIDFAC requires based upon its statutory responsibilities. Practices that CIDFAC finds objectionable include those that could create conflicts for certain finance team members, i.e., permitting the Letter of Credit provider to act as trustee and permitting bond counsel to represent the borrower. Provisions that CIDFAC requires in bond documents based upon its statutory responsibilities include the borrower's job creation representations and the borrower's indemnification of the State and its officers. Although it is probably impossible to eliminate all such discussions, staff would like to keep them to a minimum because they can disrupt the bond issuance process and consume considerable time.

CIDFAC staff proposes to work with STO counsel to document CIDFAC's bond issuance requirements. Staff further proposes to establish a working group of ~~State Treasurer's Office (STO)~~ counsel, IDB practitioners and IDB issuers to review and vet the requirements, and then ensure the final documentation of the requirements is available to all practitioners, issuers and borrowers (e.g., through posting on CIDFAC's website, inclusion in the IDB applications, email to all on CIDFAC's mailing list, etc.).

Status: CIDFAC staff has had preliminary discussions regarding this proposal with STO counsel and with IDB practitioners. The response has been positive.

- **CDLAC Point System:** *Staff proposes CIDFAC work with the IDB community and CDLAC to reevaluate the current point scheme. Staff anticipates bringing a revised point scheme to the CDLAC and CIDFAC boards for approval at the end of 2008 for implementation in 2009.*

CIDFAC staff believes the job creation formula needs to be changed, the job retention requirements need to be clarified, health care benefits should carry more weight, and an environmental benefits category needs to be added so points can be earned for green manufacturing.

Status: CIDFAC staff has received verbal and written comments from practitioners and issuers regarding the current CDLAC point system. Additionally, staff has conducted research on the current state of manufacturing in California. Working with interested parties and CDLAC, staff is developing a draft proposal for revising the point scheme. ~~Staff anticipates requesting the Commission's approval and CDLAC's approval of a new point scheme in advance of the 2009 allocation round.~~

Near-Term Marketing and Outreach Proposals

- Recent discussions with representatives of California state and local governments and businesses have made clear these groups generally are unaware of economic development and business incentive programs available in the state, including those administered by state agencies. Typically, local government agencies and some State agencies are the first to be contacted when a manufacturer wants to locate or expand in the state.

CIDFAC staff proposes the following near-term marketing and outreach initiatives to boost the visibility and viability of the state's IDB programs. These efforts will target immediate steps to market the state's IDB program to state and local governments, economic development associations and other organizations which have direct dealings with California manufacturers:

- **State Government:** CIDFAC staff has made a number of contacts with economic development program representatives in state government, including the California Business Investment Services ("CalBIS"), a division of the California Labor and Workforce Agency, and the Governor's economic development staff. CIDFAC staff also has made contacts at the California Energy Commission and agencies under the CalEPA umbrella, including the Integrated Waste Management Board and the Air Resources Board, all of which offer incentive programs to certain targeted "green" businesses.

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CIDFAC staff proposes to expand contacts with program representatives within these agencies by participating in their sponsored workshops and conferences.⁸ In addition, CIDFAC staff proposes to expand its state-level contacts to include:

- ✓ **The Employment Training Panel (ETP):** According to its website, the ETP is a business- and labor-supported agency that helps employers strengthen their competitive edge by providing funds to offset the costs of job skills training necessary to maintain high-performance workplaces. ETP lists the following program information on its website:
The ETP program is performance-based, providing funds for trainees who successfully complete training and are retained in well-paying jobs for a specific period of time. The program is funded by the Employment Training Tax paid by California employers, and targets firms threatened by out-of-state and international competition.

Since its inception in 1983, the ETP program has provided more than \$1 billion to train more than 660,000 workers in more than 60,000 California companies. Employers match ETP-provided training funds. ETP also funds training for unemployed workers. The agency prioritizes small businesses and employers in high unemployment areas of the state. Many of the businesses to which ETP has granted training funds are manufacturers.

With CIDFAC's emphasis on job creation and job retention, staff believes developing a working relationship with the ETP will provide manufacturers seeking IDB financing another means to help retain and expand their workforces.

Particularly as CIDFAC seeks to promote access to the state's IDB program by green manufacturers, it will be important that these companies also have access to properly trained workers.

At a recent summit on California's green economy, corporate and government leaders voiced concern over a shortage of qualified labor in the state. These leaders emphasized the green-tech industry needs not only college-educated engineers and scientists, but also skilled laborers trained in construction and electrical work. They believe that "[i]f California schools don't start training young people for these jobs, the green-tech industry will either move elsewhere or import skilled workers from outside the state. And working-class Californians, who could fill many green jobs with the right preparation, will find themselves locked out of the new economy."⁹

⁸ Note that, over the last three years, CIDFAC staff has been a participant in the Integrated Waste Management Board's advisory committee on plastics recycling.

⁹ Baker, David R. "State Has Serious Green-Collar Labor Shortage, Summit Attendees Say," San Francisco Chronicle, January 15, 2008. (It is noteworthy that Los Angeles' Mayor Villaraigosa recently announced an economic action plan that he says will create 100,000 jobs over the next two years.

- **Local Government:** CIDFAC staff believes some of the most important contacts at the local level are energy providers (e.g., PG&E, SoCal Edison, SMUD, etc.), industrial development authorities and economic development agencies. These contacts are crucial because: (1) manufacturers traditionally use substantial amounts of energy to run their production facilities, and energy costs are one of the largest contributors to their cost of doing business in California; and (2) local agencies have established relationships with businesses in their jurisdictions and generally are the first to work with manufacturers seeking to expand or locate in their communities.

When seeking IDB financing, small manufacturers often inquire about energy and other incentive programs at the local level. To enhance the value of its IDB program, CIDFAC should be in a position to offer information on these programs and provide contact information.

In its work on recent projects (e.g., Betts Springs), CIDFAC staff has made contacts at PG&E, SMUD and the California Public Utilities Commission regarding energy programs for small manufacturers. With respect to local government representatives, CIDFAC staff has longstanding relationships with the City of Los Angeles and Alameda County, which operate the state's two most active industrial development programs. To increase its local contacts, CIDFAC proposes to:

- ✓ Directly contact the small business representatives at Southern California energy providers to establish relationships.
- ✓ Directly contact local agencies involved with IDB projects that come before CIDFAC in order to establish working relationships.
- ✓ Participate in conferences, workshops and meetings sponsored by the League of California Cities and the California Association of Counties (CSAC). In particular, CSAC has an Economic Development Policy Committee that holds regular public meetings to discuss county issues and legislation related to local economic development.
- ✓ Expand CIDFAC's involvement with the national and local economic development associations to increase contacts with California-based economic development practitioners.

CIDFAC staff serves on the board of the national association, the Council for Development Finance Agencies (CDFA). This year, staff has been

According to his announcement, the Mayor has used various training programs to provide the City with 36,000 jobs in various sectors. He plans to use similar training programs for his 100,000 goal, and he is targeting jobs in green industries.)

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working closely with CDFA's executive director, its research and policy staff, and its Washington D.C.-based lobbyist on changes to federal legislation affecting IDBs. CIDFAC staff attended CDFA's annual conference in April.

CIDFAC staff has renewed its membership on the board of the California Association of Local Economic Development (CALED). Staff plans to regularly participate in CALED's workshops and conferences.

- **Environmental Organizations:** CIDFAC staff has established relationships with environmental advocacy organizations, including: the Sierra Club; the Natural Resources Defense Council; Californians Against Waste; the Union of Concerned Scientists; and the Center for Energy Efficiency and Renewable Technologies. Staff also has developed working relationships with academics working in fields related to environmental policy and technology. Staff proposes CIDFAC continue and expand such relationships.

Additionally, staff proposes establishing and cultivating a close working relationship with the Apollo Alliance. One of the Alliance's primary missions is to help communities develop a solid job base in the green economy. IDB financing could help accomplish that mission.

Staff also recommends making contacts with environmental organizations formed by industry. As a first step, staff recommends CIDFAC become a member of the Northern California chapter of the U.S. Green Building Council (USGBC). Such membership is inexpensive and, among other things, would provide contacts with leaders in the green building industry and access to resources and specialized training in green building and LEED certification.

As mentioned above, green buildings and green building materials are an important component of green manufacturing. As CIDFAC targets green manufacturers for its IDB program, we will need to fully understand the LEED certification program and have access to expertise in the industry.

- **Other Marketing Efforts:** CIDFAC staff also proposes the following:¹⁰
 - ✓ Update and enhance CIDFAC's existing marketing materials for distribution to CIDFAC's mailing list, at conferences, meetings, seminars, and symposiums, and for posting on CIDFAC's website.

¹⁰ It should be noted that some of the best marketing outcomes are the result of serendipity. For example, CIDFAC staff recently heard a business report on the local public radio station about a Sacramento plastics recycler that is looking for low cost financing for a new facility. CIDFAC staff contacted the company regarding the possibility of IDB financing and referred the company to CalBIS for assistance with other possible state and local incentive programs.

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- ✓ Work with the League of California Cities and CSAC to market CIDFAC's program in their publications and on their websites.
- ✓ Make CIDFAC staff available to speak at targeted association, economic development and environmental conferences.

Longer-Term Program Actions

- **State Legislation:** *Staff recommends the STO sponsor legislation to greatly expand CIDFAC's extremely limited authority to issue IDBs.* Staff recommends such legislation take effect no later than January 1, 2010. This move would provide manufacturers more options when seeking low-cost, tax-exempt financing. Additionally, it would make CIDFAC a more important actor in the state's economic development theatre. By becoming an active issuer of IDBs, CIDFAC would offer local governments more options for financing the location or expansion of manufacturers in their jurisdictions.

Status: ~~CIDFAC staff has drafted a legislative proposal to expand CIDFAC's IDB issuance authority, proposed legislation that would amend its statute to expand its authority as an issuer of IDBs.~~

- **Issuance Costs:** The cost of access to the municipal bond market – including the cost of issuance and, particularly, the cost of credit enhancement – can be substantial. For IDB issues (no more than \$10 million in principal), certain issuance costs are somewhat “fixed” and do not necessarily fluctuate with the size of the issue. Consequently, these costs can be large relative to the principal amount. For small or new manufacturers, the cost of issuance and the cost of credit enhancement can make IDB financing less accessible.

Staff proposes CIDFAC explore the possibility of obtaining federal or state grant funds to finance a pilot project under which CIDFAC would cover certain costs of issuance or certain credit enhancement costs for small manufacturers or specific types of manufacturing projects. The parameters of the pilot project largely would be driven by the grant requirements.

Status: CIDFAC staff has conducted preliminary research into federal and state grant programs [e.g., grant programs managed by the Small Business Administration, the U.S. Environmental Protection Agency (EPA), the California Department of Conservation, CalEPA, and the state Business, Transportation and Housing Agency].

- **Federal Legislation:** *CIDFAC staff has been working with CDFA in support of federal legislation to extend IDB financing to “knowledge-based” industries.* Under current federal tax law relating to IDBs, “manufacturing facility” is defined as any facility which is used in the manufacturing or production of tangible property.

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CDFA proposes to expand this definition to include facilities which manufacture, create or produce both tangible and intangible property.

CDFA believes the proposed definition would be sufficiently broad to cover patents, copyrights, formulas, processes, designs, patterns, know-how, format and other similar items.¹¹ CDFA argues that, although “the changing economy in the United States is providing new and exciting employment opportunities for [its] citizens, in the area[s] of software development and biotechnology...the tax-exempt bond finance programs operated by state and local development agencies do not extend to these important and growing sectors of our economy ...

“Congress should upgrade and modify the definition of manufacturing as it pertains to the small-issue [industrial development] bond program to allow accessibility for private businesses that are creating, and will continue to create, the jobs of tomorrow ... Adding a category of private activity use allowing ‘knowledge based’ companies to be eligible to take advantage of tax-exempt financing would promote economic development in our local communities as well as nationwide.”¹²

[See Treasurer Lockyer’s January 23, 2008 letter to California’s U.S. senators and House delegation supporting CDFA’s legislative proposal (Attachment A) and a list of discussion points regarding the proposal and how it would benefit California (Attachment B).]

Status: Bipartisan legislation was introduced April 17, 2008 in the U.S. Senate to make the definitional change. CIDFAC staff will work with CDFA and directly with members of the California Congressional delegation to garner support for the measure, as well as any companion bill introduced in the House of Representatives. The Treasurer supports this proposal and stands ready to assist the advocacy effort if needed.

CIDFAC staff has been working with CDFA in support of federal legislation that would allow community banks to partner with their Federal Home Loan Banks in issuing letters of credit to support tax-exempt IDBs.

CDFA and many IDB practitioners believe that legislation that will allow Federal Home Loan Banks to support credit enhancement offered by community banks will make IDB financing a much more viable option for many small manufacturers.

¹¹ CDFA’s proposal refers to the definition of ‘intangible property’ contained in Internal Revenue Code Section 197(d)(1)(C)(iii). Note also that CDFA’s proposal includes clarification of the definition of manufacturing facility so that there is differentiation between “functionally related and subordinate facilities” and “directly related and ancillary facilities.” According to CDFA, this distinction is used for other types of private activity bonds, and it is important because there is no 25% limitation on “functionally related and subordinate facilities” (e.g., short-term warehousing facilities, testing labs, etc.) as there is on “directly related and ancillary facilities” (e.g., long-term warehousing facilities, sales offices, etc.).

¹² Excerpted from CDFA materials distributed to its members and posted on its website.

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- **Letter of Credit Support:** Currently, the California State Teachers' Retirement System (CalSTRS) offers letter of credit support ("wraps") for IDB borrowers whose letter of credit banks are local or regional banks which are not rated by the rating agencies. Borrowers often want to obtain letters of credit from the local or regional banks with which they have an existing business relationship. In these cases, CalSTRS provides a credit "wrap" to the bank's letter of credit, and the bond issue thereby carries CalSTRS' investment-grade rating.

Obtaining cost-effective credit support is a substantial challenge for small manufacturers, especially those in emerging industries such as the knowledge-based or new green economy sectors. This problem is exacerbated when access to private credit is tight. If CalSTRS and/or CalPERS could provide another source of direct credit support, manufacturers would have another means to access affordable credit enhancement and the IDB market.

Whether or not CIDFAC becomes an issuer, CIDFAC staff recommends initiating discussions with CalSTRS and the California Public Employees' Retirement System (CalPERS) about providing first-line letters of credit for IDB transactions, possibly at relatively low-cost, for certain targeted projects (e.g., green manufacturers).

Longer-Term Marketing Proposals

- **Marketing In Response to Legislative Changes:** If the proposed state legislation and federal legislation are enacted, CIDFAC would change its marketing plan as follows:

Enactment of the state legislation to expand CIDFAC's role as an issuer would require that CIDFAC market its issuer programs directly to California cities and counties. Most of these local jurisdictions do not have active issuance programs, and CIDFAC can offer them a source of low-cost financing for manufacturers locating or expanding in their jurisdictions. In addition to marketing the issuance program through the associations noted above, CIDFAC would develop a strategy of contacting targeted cities and counties, and regional government associations, to inform them about the availability of the issuance program.

Enactment of the federal legislation to expand the definition of manufacturing facilities would require CIDFAC to amend its marketing plan to include knowledge-based industry associations [e.g., the California Biotechnology Foundation, BayBio (a Northern California life sciences association) and the Northern California Nanotechnology Initiative)].

Given the close ties between California universities, which are involved with the research and development of knowledge-based technologies, and the state's

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businesses, which commercialize the technologies, CIDFAC would need to assess the value of including the universities' research institutes in its marketing efforts.

POSSIBLE IMPACTS OF STRATEGIC PLAN

Increased Allocation for IDBs from State Debt Ceiling

Effective implementation of this plan and its underlying objectives – strengthening CIDFAC, creating good-paying jobs, and spurring the state’s green economy – will require changes in how the state allocates the tax-exempt, private activity bond cap received annually from the federal government. At least in recent history, IDBs have received just a sliver of the allocation pie. For this plan to be fully realized, IDBs will have to get a larger piece.

Consider 2008. California’s tax-exempt debt ceiling from the federal government totaled \$3.107 billion. The California Debt Limit Allocation Committee (CDLAC) approved the following allocations from that pot, and as in prior years, gave IDBs the smallest share:

- Housing projects -- \$2.33 billion, or 75%
- Solid waste disposal and recycling projects -- \$430 million, or 13.8%
- Student loans -- \$225 million, or 7.2%
- IDBs -- \$120 million, or 3.7%

Low demand, restrictions in federal law that further depressed demand and other factors help explain IDBs’ low allocation stature. However, in the past two years changes in federal law have increased demand for IDB financing. In 2007, for example, IDBs received from CDLAC an initial allocation of \$68 million. But by year’s end, total IDB demand topped \$98 million. IDBs’ initial allocation for 2008 totaled \$120 million. At the end of June, less than \$40 million will remain available, indicating another year in which demand for IDB financing likely will exceed the initial allocation.

Key elements of this plan – aggressive marketing, fostering green manufacturing, making CIDFAC an issuer, and expanding federal IDB law to cover knowledge-based companies and allow Federal Home Loan Banks to extend credit enhancement to IDB issues – will further heighten demand. To make the plan work, then, IDBs will need to receive a bigger portion of California’s annual private activity bond allocation.

Increased Staffing Needs

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To fully implement all phases of this plan, additional staff will be required. Staff is working with STO to assess the potential needs and develop a strategy to ensure adequate staff and resources for CIDFAC as the strategic plan unfolds over time.

Attachment A



BILL LOCKYER
TREASURER
STATE OF CALIFORNIA

January 23, 2008

The Honorable Xavier Becerra
U.S. House of Representatives
Longworth Building, #1119
Washington, DC 20515

Dear Congressman Becerra:

Xavier

As Congress considers proposals to pump life into our lagging economy, I urge you to support efforts to include in any stimulus package a provision that will greatly benefit California businesses and working families.

Legislation sponsored by the nationwide Council of Development Finance Agencies (CDFA) would change the federal definition of "manufacturing facility" to ensure high-tech and biotech enterprises qualify to obtain tax-exempt, industrial development bond (IDB) financing. As California's State Treasurer and as Chairman of the California Industrial Development Financing Advisory Commission, I believe the amendment would help spur our state's recovery from economic doldrums caused by the housing downturn and other factors.

IDBs are tax-exempt financings that provide small- and mid-sized companies a low-cost alternative to traditional credit markets. Current federal law defines "manufacturing facility," for purposes of determining eligibility for IDB financing, as a facility which produces tangible property. The CDFA proposal would expand the definition to also include facilities which produce intangible property. The broader definition would apply to high-tech, biotech and other knowledge-based firms, enabling them to access low-cost financing to cover their capital investments. The result? Business and job expansion that would not occur with more expensive financing options.

California's businesses and workers stand to profit substantially from the proposed legislation. Our state is at the forefront of the knowledge-based economy. The state's leadership in the biotech and high tech fields is well-known, and California is positioned to become the hub of research and commercial activity in the emerging nanotech and geospatial tech sectors as well. Many of these knowledge-based firms are small businesses, which are the target recipients of IDB financing and are the drivers of California's economy. The following are a few examples of how this change would benefit California:

Attachment A

January 23, 2008
Honorable Becerra
Page two

- California leads the country in the number of biotechnology firms. In 2005, according to Ernst & Young's 2007 report, "Beyond Borders: The Global Perspective," California was home to 375 of the nation's 1,415 biotech companies and 53,000 of the nation's 250,000 biotech workers. Roughly one in every three U.S. biotech firms is located within 35 miles of a UC campus. About two-thirds of biotechnology firms employ 135 workers or fewer.
- Nanotechnology is perhaps even more of an emerging field than biotechnology, and promises major breakthroughs in engineering, medicine and science. Under the President's High Growth Job Training Initiative, the National Nanotechnology Initiative recently received a \$1.5 million grant to fund a California Nanotechnology Workforce Training Program under the auspices of the California Institute of Nanotechnology. According to the California Institute of Nanotechnology, the National Science Foundation deems nanotechnology to be one of the highest growth sectors in the United States, and estimates it will create more than one-million jobs by 2015.
- In California, occupations identified as "geospatial technology-related" are expected to grow much faster than average between 2004 and 2014, adding nearly 100,000 new jobs across all industries.

Providing access to low-cost, tax-exempt IDB financing will encourage the growth and expansion of these companies within the state and will create the potential for hundreds of new, high-paying jobs for California workers.

Your staff may contact Eileen Marxen, Deputy Executive Director of the California Industrial Development Financing Advisory Commission, at (916) 653-9129, for further information. Do not hesitate to call me directly. Your support will be crucial as Congress develops an economic stimulus package, and I would welcome the opportunity to talk with you about this important legislation for California.

Sincerely,



BILL LOCKYER
State Treasurer

cc: California Congressional Delegation
Mr. John McMickle, Council of Development Finance Agencies
Mr. Brian Anderson, Council of Development Finance Agencies

Attachment B

**TAX-EXEMPT BOND FINANCING FOR BIOTECH/HIGH-TECH
Proposal to Expand Definition of ‘Manufacturing Facility’
Talking Points**

PROPOSAL

- *Make high-tech, biotech and other knowledge-based firms eligible for tax-exempt industrial development bond financing by expanding the definition of “manufacturing facility” under federal law to cover intangible property.*
- Current law defines “manufacturing facility” as a facility used to produce tangible property. (Section 144 of the U.S.C).
- The change sponsored by the Council of Development Finance Authorities (CDFA) – the nationwide association of state and local economic development agencies – would broaden the definition to include facilities that manufacture, create or produce both tangible and intangible property.
- The objective is to bring IDB financing into the new and emerging economy, and give access to crucial capital to biotech, high-tech and other “knowledge-based” companies.
- The expanded definition would be sufficiently broad to cover software, patents, copyrights, formulas, processes, designs, patterns, know-how, format and similar intellectual property.
- The change would provide substantial economic benefits to California businesses, workers and their families.
- *It would not cost the federal government any money; it just would expand the pool of companies eligible to receive tax-exempt bond financing.*

HOW IT BENEFITS CALIFORNIA

- Our state stands at the forefront of the knowledge-based economy. Our leadership in creating jobs and economic growth in the biotech and high-tech fields is well-known. But we’re also positioning California to be at the hub of activity in the lesser-known nanotech and geospatial tech sectors.
- Many of these firms are small businesses, which are the drivers of California’s economy and the target recipients of IDB financing.
- *Providing tax-exempt bond financing for these firms will allow them to grow in California, create thousands of high-paying jobs, keep the state on the cutting edge of the new economy and sharpen our state’s competitive edge.*

Attachment B

DATA POINTS AND BACKGROUND

- *California leads the country in the number of biotech firms.* In 2005, according to Ernst & Young's 2007 report, "Beyond Borders: The Global Perspective," California was home to 375 of the nation's 1,415 biotech companies and 53,000 of the nation's 250,000 biotech workers.
- *About two-thirds of biotech firms employ 135 workers or fewer.*
- The war on terrorism means more money for the biotech industry. The federal government allocated \$1.6 billion to the National Institutes of Health for biodefense research and development in fiscal year 2004. And there's more to come in the future. *California's universities are on the forefront of "biodefense" research and development.*
- To date, the California Institute for Regenerative Medicine (CIRM) has approved 156 research grants totaling almost \$260 million, making CIRM the largest source of funding for human embryonic stem cell research in the world. In the area of biotech, CIRM provides the crucial link between government- and university-sponsored research and development and commercialization of knowledge-based products.
- According to the California Employment Development Department, network systems and data communications analysts, computer software engineers and database administrators rank among the 10 fastest-growing occupations in the state. The majority of these occupations pay a high wage (more than \$40 per hour).
- Nationwide, *80 percent of IT workers are employed by small companies.*
- Nanotechnology is the creation and manufacture of mechanical devices and materials on an atomic and molecular level. It is perhaps even more of an emerging field than biotechnology, and promises major breakthroughs in engineering, medicine and science. Under the President's High Growth Job Training Initiative, the National Nanotechnology Initiative recently received a *\$1.5 million grant to fund a California Nanotechnology Workforce Training Program under the auspices of the California Institute of Nanotechnology.*
- According to the California Institute of Nanotechnology, the National Science Foundation deems *nanotechnology to be one of the highest growth sectors in the United States, and estimates it will create more than one million jobs by 2015.*
- Geospatial technology occupations include cartographer, surveyor, remote sensing scientist, mechanical drafter, aerospace engineer, civil engineer, electrical engineer, soil conservationist and many others.
- California is home to the Environmental Systems Research Institute, the California Space Authority, defense and commercial aerospace companies, world-renowned oceanic research centers and other businesses with geospatial functions. These industries will provide a launching pad for the geospatial tech sector in California.
- *In California, occupations identified as "geospatial technology-related" are expected to add roughly 100,000 new jobs across all industries by 2014.*